

Surviving a Challenging Market

This column will answer the most pressing questions we receive from members struggling in today's challenging market.



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Q: How do I reduce my chances of being audited by the Internal Revenue Service (IRS)?

A: Individuals and small businesses account for about 70 percent of all tax collections, corporations pay about 20 percent, the remainder comes from excise taxes, gift taxes, estate taxes and miscellaneous fees.

According to a recent study, 1.4 million individuals were audited in 2007. Of this, 9 percent earning over \$1 million were audited. Two percent of those who earned between \$100,000 and \$1 million were audited and only 1 percent of tax returns showing an income below \$100,000 were audited.

The IRS has also substantially increased the audit workforce and focused these new auditors on individuals with investments, partnerships and small business owners.

There are some key things you can do, however, to reduce your chances of winning the IRS lottery.

Don't embellish to anyone about how you snowed the IRS. Informers earn a 30 percent reward on additional taxes collected.

Avoid little known or secret tax "shelters."

Including offshore credit cards, family trusts and home based businesses never intended to show a profit. The only reason these scams still work is a lack of IRS resources—but that is changing.

Consider filing a paper return.

The IRS has drastically reduced its staff of paper return processors. Yes, it will delay your refund. However, a processor who has been staring at tax returns for eight hours a day for several weeks decreases the chance he or she will catch everything. E-Filed returns are processed by computers and they don't get tired.

Beware of Red Flags

The IRS uses a point system to score a small minority

of selected returns. Each flag is worth a point. This is like golf, not bowling...points are bad. The "winners" go to the top of the auditor's pile based on the total score. Here are some bogeys:

Office-in-Home Deduction

This deduction can only be claimed if you have no other office space. And only the portion of your home used exclusively for your office counts. The dining room table is out.

Business Travel

If you mix business with pleasure when traveling you can only deduct the business portion of your travel expenses. Usually this is stated as a percentage. Remember to keep all of your receipts.

Meals and Entertainment

Documentation, documentation, documentation. Generally, this deduction is for business meetings, office parties and business travel related meals (usually must be away from home overnight). This is a nasty, double bogey type hazard.

Vehicle Mileage

IRS regulations say you must keep written records of your business mileage. They do not specify when those records need to be written. Remember the first and last trip of the day are considered "commuting" and are not deductible.

Charitable Contributions

Whether cash or property, business or individual, charitable deductions exceeding 10 percent of your income will earn you a point.

This is by no means an all inclusive list of potential audit flags. You can follow all the rules and still get a nasty-gram from the Department of Treasury. Exercise discretion in these areas, however, and you may not wind up a "winner."